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STATE PASS TO USTR

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TAGS: [EPET](#) [EFIN](#) [ENRG](#) [EINV](#) [PGOV](#) [HO](#)
SUBJECT: GOH RESPONSE TO ENERGY CRISIS MAKING RICH RICHER

REF: A. A. TEGUCIGALPA 452
[1](#)B. B. TEGUCIGALPA 336
[1](#)C. C. TEGUCIGALPA 84
[1](#)D. D. TEGUCIGALPA 57
[1](#)E. E.07 TEGUCIGALPA 1818
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[1](#)G. G.07 TEGUCIGALPA 1647

Classified By: Ambassador Charles Ford, E.O. 12958 for reason 1.4 (b) a
nd (d)

[1](#)1. (C) Summary: The surge in global energy prices the past three years has left the GOH in an increasingly untenable position due to unsustainable fuel subsidies and financial losses at the National Electric Company (ENEE). Although the external price shock is the immediate cause of the crisis, Honduras is also paying the price for years of poor policy choices, including non-transparent contracts that created overdependence on high-priced fuel oil to generate electricity and campaign promises to hold down pump prices for motorists. Facing fiscal reality and IMF pressure, the GOH has allowed both pump prices and electricity rates to rise sharply in recent months, provoking public outrage and street protests. It has also issued populist threats to nationalize fuel imports and tried to sell the public on the idea that Venezuelan oil on concessional terms (Petrocaribe) will solve not only the energy crisis but the food crisis as well. However, GOH management of both the Petrocaribe deal and a recent "emergency" power contract reveal a continued proclivity for insider schemes that benefit the politically powerful while leaving the country's fundamental energy problems unresolved. On the bright side, mounting public pressure is forcing the GOH to at least talk about moving forward on renewable energy projects that have been bottled up in the bureaucracy for years. End Summary.

Fuel and Electricity Subsidies Become Unsustainable

[1](#)2. (U) With world oil prices hitting USD 135 a barrel, President Manuel Zelaya has been forced in recent months to relent on his populist promises from the 2005 campaign and allow the controlled prices for motor fuel and electricity to rise. Electricity rates began creeping up last December under a progressive formula that shields poorer households with lower usage from the bulk of the increases. Industrial and larger domestic users have seen rates rise by 40 percent or more over the past six months, with another 15-percent rate hike reportedly in the offing for June.

¶3. (U) To put these increases in perspective, EconCouns's electric bill for May (fortunately paid by the Embassy) came to USD 271 for 1,381 kilowatt hours -- 19.6 cents per kWh. This was 50 percent higher than before the rate increases. A year ago in Arlington, VA, EconCouns's combined gas and electricity bills came to USD 135, and the electric portion came to 9.3 cents a kWh.

¶4. (C) The IMF had been pushing the GOH to reduce energy subsidies, which it viewed as a ticking fiscal time bomb, for many months. ENEE losses were estimated to be running at close to USD 300 million a year -- 3 percent of GDP -- before the rate increases. Even after the rate increases, IMF experts estimate ENEE is still losing money, although they are uncertain how much.

¶5. (U) Meanwhile, power outages have become more frequent. A turbine in the El Cajon hydroelectric dam has been taken down for maintenance, aggravating the situation and making the country even more dependent on fuel oil for its power needs. The World Bank estimates Honduras needs 300 Megawatts of additional capacity within in the next three years to meet growing demand.

A Power Bid Gone Bad

¶6. (SBU) As reported in refs F and G, ENEE's response a year ago to the impending power crisis was to conduct an "emergency" direct purchase, circumventing normal open bidding procedures, for 250 Megawatts of new generating capacity. This was reminiscent of the procedure used in the 1990s that resulted in the country becoming dependent on high-priced thermal power from heavy fuel oil for nearly 70 percent of its electricity. Those earlier deals have been widely denounced in Honduras as having served only to enrich a small group of well-connected businessmen -- Freddy Nasser and the Kafie Brothers -- who are reported to have earned excessive profits off the contracts, under which they reportedly billed ENEE more than USD 1.5 billion between 2002 and 2007, although ENEE has fallen behind in payments to them in recent years and now owes them around 4 billion lempiras (USD 212 million) in arrears.

¶7. (SBU) Embassy sources say the bases for the most recent bid, conducted while ENEE was under temporary military control, were skewed to favor coal-generated power in general and the Larach family in particular. The contracts were awarded to CECSA -- a Guatemalan company with no previous power generation experience -- and to a Honduran group controlled by Canahuati and Larach interests. The Laraches and Canahuatis have substantial interests in coal production. The deals came under heavy criticism when details began to trickle out that the price per kilowatt hour would be even higher than for the current fuel oil plants.

¶8. (SBU) An audit of the contract award conducted by the Supreme Accounting Tribunal (TSC - equivalent to U.S. GAO) and funded by the World Bank found procedural and other irregularities in the process and recommended that the Honduran Congress disapprove the contracts. The TSC found the contracts, worth USD 180 million, would end up costing ENEE an additional USD 614 million because they shift to ENEE environmental and other costs that should have been borne by the contractors. It recommended that that ENEE conduct a new bid under a transparent international public tender.

¶9. (U) The TSC presented its findings in an open session that was attended by over 200 people, including the awardees, the press, and congressional members. The release of the report generated public name calling by Defense Minister Aristides Mejia, who signed the contracts and still chairs the ENEE board. He accused the President of the TSC, Moises Lopez Alvarenga, of favoring the interests of Nasser and the Kafies. Mejia also wrote a letter to the G-16 donors group questioning the motives of World Bank staffer Dante Mossi, who was involved with the audit.

¶10. (C) According to Mossi, CECSA is nothing more than an association of five bankers who got together for the purpose of bidding on the contract. None of their banks is of high repute, and their leader is rumored to have underworld connections. He concludes that CECSA is connected to the powerful and politically connected Honduran Rosenthal Family.

Petrocaribe to the Rescue?

¶11. (U) For months the GOH has been trying to convince the public that Petrocaribe fuel -- for which it will pay 50 percent down and 50 percent on credit on concessional terms -- is the answer to the country's energy needs. The cash the GOH will derive from the deal -- from paying half market price in cash to PDVSA then selling the fuel at full price to power plants and gas stations -- was to be used to recapitalize ENEE and to construct hydro plants. More recently, however, the GOH has committed the same cash to its emergency plan for boosting production of basic grains to cope with rising food prices.

¶12. (SBU) Local press reports the Pico de Aguilla⁸ tanker is scheduled to bring 82,000 barrels of diesel from Venezuela under the Petrocaribe agreement between June 2 and 4. This fuel will be distributed exclusively through UNO gas stations, owned by Freddy Nasser. It is being reported that the Petrocaribe fuel -- both the heavy fuel oil for the power plants themselves and the diesel fuel to be distributed through filling stations -- will be used in part to cancel ENEE's debt to Nasser and the Kafies. In particular, Nasser's enterprises will receive privileged access to the concessionally financed fuel.

¶13. (C) Embassy sources report that Nasser is in the final stages of acquiring the COPENA filling stations -- a Honduran-owned chain that controls about 4.5 percent of the market. COPENA's chief financial officer told EconCouns the chain has been losing money since the GOH implemented its new price formula a year and a half ago, so Nasser is able to buy them out cheap. Post infers that Nasser would only be buying a loss-making operation if he had the expectation of deriving windfall profits from access to subsidized diesel fuel. Diesel is about half of the Honduran motor fuel market. The acquisition of COPENA would double Nasser's retail holdings and give him a 10 percent share of the market.

What About Renewables?

¶14. (SBU) Despite all the controversy and high cost surrounding thermal power generation, The GOH seems unwilling or unable to approve renewable energy projects that advocates claim could produce 300 MW within a few years at a fraction of the cost currently being paid to Nasser and the Kafies. Currently 10 small private hydroelectric plants (not including the 300 MW El Cajon complex operated by ENEE) produce 47 MW of power. Three biomass plants produce another 46 MW. These projects took from three to eight years to obtain regulatory approval. Another 25 projects capable of producing a total of 125 MW have completed all required studies and documentation but are awaiting approval. According to the Association of Small Renewable Energy Producers (AHPPER) these 25 projects could be operating by the end of this year if they were granted permits.

¶15. (SBU) The two main obstacles to receiving permits, according to AHPPER, are lack of staff at the offices in the Environment Ministry (SERNA) charged with approval and the archaic views of an entrenched bureaucracy that either does not understand or believe in renewable energy, is opposed to private power projects in general or wants to approve only projects from which they can personally benefit.

¶16. (U) Under mounting public criticism for delays in

approving cheap, clean energy alternatives, ENEE Director Rixi Moncada stated publicly that the GOH supports renewable energy and will bring on line hydro and wind plants soon. However, GOH-funded TV ads focus on larger-scale hydro projects to be managed directly by ENEE. In late May the Congress approved two laws to facilitate bringing renewable projects online. One grants fast track approval to plants producing up to 5MW, up from the previous 3 MW. The other grants smaller producers the same status as those producing over 50 MW.

¶17. (U) However, significant hurdles remain to alternative energy. For example, a clause inserted in the Renewable Energy Law requires that power be delivered to the nearest substation (not the nearest point on the grid), which could entail running power lines as far as 80 km over often rugged terrain, making many small renewable projects uneconomical.

¶18. (SBU) Those small renewable energy projects that are in operation in Honduras are competitive -- selling power to the grid for 8-9 U.S. cents per kWh -- primarily because they are able to sell carbon credits to Europeans under the Kyoto Protocol's Clean Development Mechanism. For example, when one of the hydro plants was built seven years ago, the rate was USD 4.50 per ton of emissions abated (a ton of emissions is abated for every 1,250 kWh of power produced). Now the going price is 16 to 17 Euros (about USD 25).

COMMENT

¶19. (C) While Honduran households and firms struggle to pay skyrocketing electric bills and the country faces rolling blackouts in the short term for want of new power sources, the GOH, despite its populist rhetoric, appears intent on continuing business as usual -- giving sweetheart deals to insiders at the expense of sustainable economic growth. The only hope may be that Congress will find the will to reject the obviously flawed power contract awarded to CECSA and the Larach/Canahuati group and order ENEE to conduct a transparent bid that gives an equal shot to renewable producers. We can also hope that public pressure will persuade the GOH to approve at least some of the renewable projects already in the pipeline. The USG should keep the pressure on by insisting on fulfillment of the Millennium Challenge Corp's anti-corruption remediation plan, which includes a requirement to conduct a full independent audit of ENEE. End Comment.
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